

KIRKLAND M&A UPDATE

April 16, 2018

Advance Notice Bylaws – Advantage Confirmed

A recent state court decision in Washington supports the view that courts elsewhere will uphold the validity of robust advance notice bylaws as well as a company's close review of nomination notices for compliance with the bylaw requirements.

As we have [noted in the past](#), advance notice bylaws are a near universal feature of the organizational documents of public companies. In their simplest form, they set a deadline, usually between 60 and 120 days before an upcoming stockholder meeting, by which a stockholder must give notice to the company of its intention to nominate director candidates and identify those nominees. Delaware courts have repeatedly upheld the validity of these provisions holding that they are “useful in permitting orderly shareholder meetings.”

In recent years, many companies have implemented enhanced advance notice bylaws adding additional requirements such as requiring that nominating stockholders and director nominees provide information about themselves and their holdings. Some bylaws go further and include “director qualification” provisions requiring nominees to make certain representations (e.g., about willingness to comply with company policies and not being party to voting commitments).

While these enhanced features have not been tested in Delaware courts, the prior cases suggest that they should be upheld as long as they do not “unduly restrict the stockholder franchise” and are not “applied inequitably.” A [recent decision](#) from a Washington state court supports this result.

In this case, an activist hedge fund delivered a notice of two director nominations right before the deadline set in the advance notice bylaw of a Washington company. While the 133-page submission included a lot of the information required by the company's robust advance notice bylaw, the company identified more than 30 deficiencies in the nomination notice and related mandatory questionnaires, and therefore rejected the nominations as being non-compliant. Almost half of the issues identified by the company resulted from the bylaw's incorporation of extensive SEC regulations so that everything that would have to be disclosed in a proxy statement had to be included in the notice. The activist sought to supplement the original notice to cure some of the asserted deficiencies, but it delivered the supplemental information after the submission deadline.

The activist sued in Washington state court, seeking an injunction against the company's rejection of its notice. The activist relied heavily on a Washington Supreme Court case that described the right of a shareholder to vote as “a valuable and vested property right . . . that should not be annulled for purely technical reasons”. The activist argued that the bylaw requirements were unclear and that in any event, it had provided everything that would be material. The court denied the injunction, finding that the company's advance notice bylaws were “common” and “valid” and that the activist had failed to comply with the requirements. The judge went on to hold that the board's rejection of the notice was an exercise of its business judgment that should not be overturned. While this decision came from a state court under Washington law, it supports the view that courts elsewhere will uphold the validity of robust advance notice bylaws as well as a company's close review of nomination notices for compliance with the bylaw requirements. Where the bylaw requirements are in place on a “clear day” before an activist or hostile bidder surfaces, courts are more likely to defer to a board decision to apply those requirements strictly as compared to the enhanced scrutiny courts sometimes apply to defensive steps taken in response to a known threat. In addition to these legal considerations, companies considering strict enforcement of these bylaws should be mindful of the possible IR/PR implications of doing so.

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